

Internal Audit Report

HOWARD COUNTY
DEPARTMENT OF PUBLIC WORKS
DEPARTMENT OF RECREATION AND PARKS
CONTRACT COMPLIANCE
REAL ESTATE LEASES
OCTOBER 2006

Office of the County Auditor





OFFICE OF THE COUNTY AUDITOR

Ronald S. Weinstein, CPA
County Auditor

October 2006

The County Council and County Executive
of Howard County, Maryland

Pursuant to Section 212 of the Howard County Charter and Council Resolution 22-1985, we
have conducted a review of selected activities of the

DEPARTMENT OF PUBLIC WORKS
DEPARTMENT OF RECREATION AND PARKS
CONTRACT COMPLIANCE - REAL ESTATE LEASES

and our report is submitted herewith. The scope of our examination related specifically to a review
of Real Estate Leases. The body of our report presents our findings and recommendations.

The contents of this report have been reviewed with the Chief Administrative Officer, and
the Director of Public Works and with representatives of the Capital Projects and Park Planning
Division of the Department of Recreation and Parks. We wish to express our gratitude to the Real
Estate Services Division of Department of Public Works and the Capital Projects and Park Planning
Division of the Department of Recreation and Parks for the cooperation and assistance extended to
us during the course of this engagement.

A large, stylized handwritten signature of Ronald S. Weinstein in black ink.

Ronald S. Weinstein, C.P.A.
County Auditor

A smaller handwritten signature of Leo Oken in black ink.

Leo Oken, C.P.A.
Auditor-in-Charge

SUMMARY

The Office of the County Auditor has performed a compliance review of real estate lease agreements entered into by the County. Our review included leases where the County is the leaseholder and leases where the County is the landlord. Our scope included all real estate lease contracts presently in force and all payments related to these contracts made or received during fiscal year 2005 and the first half of fiscal year 2006. We found that the County and the other parties to the lease agreements appear to be in compliance with the terms of these contracts. In addition, our review indicates that the personnel who are responsible for administering County leases have generally adhered to the policies and procedures that govern these kinds of transactions.

We made two recommendations regarding the appropriate storage and safekeeping of original signed copies of lease agreements. We also recommend that one original signed copy of all lease agreements be consolidated in a single area to which access is restricted and disaster recovery is appropriately taken into consideration.

INTRODUCTION AND SCOPE

Maintaining compliance with Howard County regulations and with the provisions of lease agreements requires careful coordination between several different County agencies including the Department of Public Works, the Department of Recreation and Parks, the Office of Law, the Department of County Administration, the Department of Finance and User Agencies. We examined lease agreements in which the County is both leaseholder and landlord to determine that: 1) the County is in compliance with the Howard County Code, Section 1, Purchasing and Section 2, Real Property Acquisition, and 2) the parties to each agreement are in compliance with their respective terms and conditions.

Due to current favorable market conditions, many commercial real estate landlords are no longer willing to accept single year commitments and are requiring that lessees consent to multi-year leases. As a result, many of the recent commercial leases entered into by the County are multi-year agreements. County regulations state that "any contract requiring the payment of funds from appropriations of subsequent fiscal years shall be made or approved by ordinance, pursuant to section 612 of the Howard County Charter." We verified that a bill approved by the County Council properly supported all lease agreements whose term exceeded one year. We

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also confirmed payments made or received under lease contracts for FY 2005 and FY 2006 and reviewed the lease agreement to substantiate that each contract appeared to represent an "arms length" transaction.

BACKGROUND

Leasing of Office Space

When a County agency identifies a need for additional office space, the agency must submit a detailed proposal to the Real Estate Services Division of the Department of Public Works. The proposal should include any location preference, total square footage requirements, a layout of proposed office and secretarial spaces, telephone and electrical requirements, and any other specific needs. Once Real Estate Services has reviewed the proposal and the User Agency has addressed any concerns raised, the proposal is forwarded to the Chief Administrative Officer for review and approval. Upon authorization by the Chief Administrative Officer, the proposal and a purchase requisition are forwarded to the Office of Purchasing where a Request for Proposal (RFP) is drawn up and disseminated to the public. Interested parties submit bids to the Office of Purchasing where they are compiled and forwarded to Real Estate Services. The bids are reviewed and discussed with the User Agency. Typically, the proposal that best meets the needs specified in the RFP at a competitive cost per square foot is chosen. If no bids are acceptable, the RFP process must be repeated before the User Agency's need for office space can be satisfied.

Once the successful bidder has been chosen, the Real Estate Services Division prepares a lease agreement between the potential landlord and the County. Wherever practical, the division uses a standardized form that contains the necessary provisions that spell out each party's rights and responsibilities. Depending upon the prospective landlord's prerequisites and the complexity of any issues concerning the lease terms that arise, the document may be revised several times before a lease agreement that is acceptable to all parties is finalized. This agreement is forwarded to the Office of Law for review and determination of legal sufficiency. Once approved, the document is returned to Real Estate Services and four original copies are forwarded to the landlord for approval and signature. Upon receipt of the lease agreement executed by the landlord, Real Estate Services sends the agreements to the required signatories execution, (the

County Executive, the Chief Administrative Officer, the County Solicitor, the Director of the Department of Public Works, and the Director of Finance) for their review and execution.

Once a lease agreement has been fully executed by all parties, Real Estate Services forwards four original agreements of lease to the Office of Purchasing for processing of the purchase requisition. Purchasing retains one original lease agreement and forwards one original lease and the original purchase order to the Landlord. A copy of the purchase order and one original lease agreement are forwarded to both the Real Estate Services Division and to the Department of Finance. When the purchase order and lease are received, Real Estate Services prepares the necessary delivery reports needed to process the first year's monthly rent payments. The division also prepares a memorandum to the Bureau of Facilities and Risk Management advising them of the newly leased property

Real Estate Services uses a detailed "Leasing of New Office Space" checklist to ensure that all steps outlined in the process described above are completed and documented. In addition, the division uses a proprietary database software product to maintain all pertinent information regarding leases to which the County is a party. Using this database, the division tracks lease anniversary dates and other essential lease data. Six months before the expiration of a lease, the division sends a memorandum to the user agency regarding renewal of the agreement. In the event that the tenant requests renewal of the lease, the division prepares an amendment to lease agreement that is forwarded to the Office of Law for review and approval. Subsequently, the amendment is routed through the same review and approval process as the original lease agreement.

Leasing Real Estate From the County

Periodically, the Department of Recreation and Parks purchases real estate for the expansion of existing parks and for future park sites. The actual purchase transaction is dependent upon the availability of desirable real estate and the limitations of the agency's budget. The Capital Projects and Park Planning Division coordinates the purchase of real estate for future park use with the Real Estate Services Division of the Department of Public Works. All real estate purchases are subject to the approval of the Director of the Department of Recreation and Parks. When the purchase has been approved, the Administrator of the Capital Projects and Park Planning Division conducts a final inspection of the property. Any significant impediment that might alter the proposed sale is eliminated prior to settlement. Once the Office of the County Auditor

property is transferred to the County, its management becomes the responsibility of the Capital Projects and Park Planning Division.

Property acquisitions that include a house or other usable structures are evaluated for possible rental opportunities. This practice was initiated to combat vandalism of properties left unattended when the former owners vacate the premises. Before a property is considered for rental, the Park Renovations and Maintenance Division inspects the property to establish if any repairs are needed to make it safe, habitable and marketable. In addition, an inspector accredited with the Maryland Department of the Environment (MDE) conducts a separate evaluation to identify any lead, lead paint, or peeling paint. If the survey finds that lead paint is present, an accredited contractor must abate the paint problem to the satisfaction of MDE and issue a Full Risk Reduction or Lead Free certificate.

When a property is deemed safe and suitable for rental. Capital Projects and Park Planning prepares a lease agreement that is forwarded to the agency Director, the division administrator and to the Chief of the Bureau of Parks and Program Services for review. When approved by these individuals, the lease is forwarded to the Office of Law for review and approval. The approved agreement is forwarded to the Office of Purchasing where an RFP is prepared for advertisement in the Howard County Times and on the Internet. In addition, the Department of Recreation and Parks contacts people who have requested notification when a County-owned property is available for lease.

Once the bidding process is concluded, the Office of Purchasing forwards a summary of the offers to the Department of Recreation and Parks for review and selection of a tenant. The Leasing Manager and the Director are responsible for choosing the tenant. Prospective tenants who offer the highest bids are typically the ones selected, subject to a credit and reference checks. Bidders with unacceptable credit histories and/or criminal records can be rejected. Successful bids by persons who are County employees must be reviewed and approved by the Ethics Committee.

When the lease agreement has been executed, Capital Projects and Park Planning retains an original signed lease agreement and a copy is provided to the Real Estate Services Division of the Department of Public Works. Data regarding the terms and conditions of the lease are entered into the database maintained by the latter division, but the responsibility for administration of the lease remains with the Department of Recreation and Parks.

In several cases, the Department of Recreation and Parks has drafted agreements that are commonly referred to as "custodian" leases. In addition to including the terms of a standard lease agreement, these contracts require the tenant(s) to perform certain specified duties related to the security and upkeep of the property. In addition, the County leases unused land for cultivation in what is referred to as a "farm" lease. These types of agreements are typically one year in duration and may include thirty (30) additional one-year options. Either party to the lease can terminate the agreement with sufficient written notice. These agreements are set up as "year-to-year" with multiple options in consideration of the inherent risk and uncertainty associated with farming.

FINDINGS AND RECOMMENDATIONS

The Real Estate Services Division retains a signed original copy of lease agreements in a fireproof file cabinet for safekeeping. The file cabinet appears to have been in service for many years and its UL (Underwriters Laboratories) fire rating is limited to one hour. Although service lives of this type of equipment are typically lengthy, the Division should evaluate the continued safekeeping capability of the cabinet. In particular, the type of insulation (wet vs. dry) used in its manufacture should be of concern. "Dry" insulation is preferable, because of the possibility of moisture damage to the contents of cabinet built using "wet" insulation. Based on these observations, we recommend that:

- I. The Division evaluates the physical condition of the file cabinet and determines what type of insulation (wet vs. dry) was used in its manufacture. If it is determined that the file cabinet's efficacy is no longer satisfactory, the Division should replace it with a fire proof storage container that was manufactured using "dry" insulation and has a UL fire rating of at least two hours.

Administrative Response:

After receiving the Auditor's report, the Department of Public Works requested a legal opinion regarding the scanning of the original leases and storing the originals off-site. The Office of Law has indicated that the active original leases and other original unrecorded documents must be stored in a fireproof safe. As a safeguard these documents should be scanned as soon as possible once they are signed and then placed in a fireproof safe. Based on this opinion, the Real Estate Services Division will immediately relocate all original leases to the fireproof safe that has been reviewed and approved by the Auditor's Office. Lease files will be

scanned into the Real Estate Services Division scan files. The Department of Public Works will initiate a new policy to scan all new lease or amendments as they are executed.

As noted in recommendation # 1, the Real Estate Services Division retains a signed original copy of lease agreements in a fireproof file cabinet for safekeeping. During our review of lease documents, we noted that the file cabinet containing original signed leases is not locked at any time. We confirmed this practice with the Chief of the Real Estate Service Division. Because the files stored in this cabinet contain original legal documents that would be difficult to replace, we recommend that:

2. The file cabinet used for storage of original lease documents be secured at the end of each normal business day. Custody of key(s) to unlock the cabinet should be limited to the Division chief and her designee.

Administrative Response:

The Administration concurs with this recommendation. With the relocation of the leases, the fireproof safe will be locked at the end of each day and the key will be secured with the Chief, Real Estate Services division.

The Capital Projects Division of the Department of Recreation and Parks negotiates lease agreements for real estate that the County detennines are available to rent. The Division maintains the original signed copies of lease agreements in several file cabinets that are not fireproof, nor do they appear to be secured after normal business hours. Copies of all leases administered by the Department of Recreation and Parks are provided to the Real Estate Services Division of the Department of Public Works. The pertinent details of these leases are entered into the database of County leases maintained in the Real Estate Services Division. To adequately secure original signed lease agreements, we recommend that:

3. Original signed copies of leases administered by the Department of Recreation and Parks be stored in a secure, fireproof cabinet for safekeeping. This could be accomplished simply by storing the original signed leases in the same fireproof and secure file cabinet maintained by the Real Estate Services Division. The person administering the leases could use copies of the original leases to carry out the necessary functions. In addition, since all original signed leases of this type would be maintained in a single location, retrieval of an original document would be facilitated.

Administrative Response:

The Administration agrees that the original signed copies of leases administered by the Department of Recreation and Parks should be stored in a secure, fireproof cabinet for safekeeping. The Real Estate Services Division of the Department of Public Works will keep original signed documents in a secure fireproof cabinet and a second original signed document will be kept in the Department of Recreation and Parks.

During our review of lease documents, we noted that lease agreements typically contain an escalation clause that provides for a 4 % increase in the tenant's rent at the time of renewal. However, we also noted that the escalation rights were not exercised in all cases. We were informed that was not intentional and could have been a lapse on the part of whoever updated the renewal lease. The current practice followed is to exercise escalation rights on all lease renewals where such provision is included in the lease.

4. Ive recommend that the Division review recent lease renewals to identify any cases where the escalation clause may have been missed. Wherever practical, these tenants should be contacted regarding the billing error and a request made to collect the difference in rent paid versus the correct amount.

Administrative Response:

The Administration concurs with this recommendation. The Department of Recreation and Parks recalls only one occasion when an escalation clause may have been missed. When this was discovered, it was immediately corrected. Procedures have been set up whereby the Departments of Finance and Recreation and Parks jointly and independently review and track these increases. The Department of Recreation and Parks does not believe that any further actions are warranted at this time.

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